

Absolute Return Strategies Program Update

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Absolute Return Strategies* Program Update

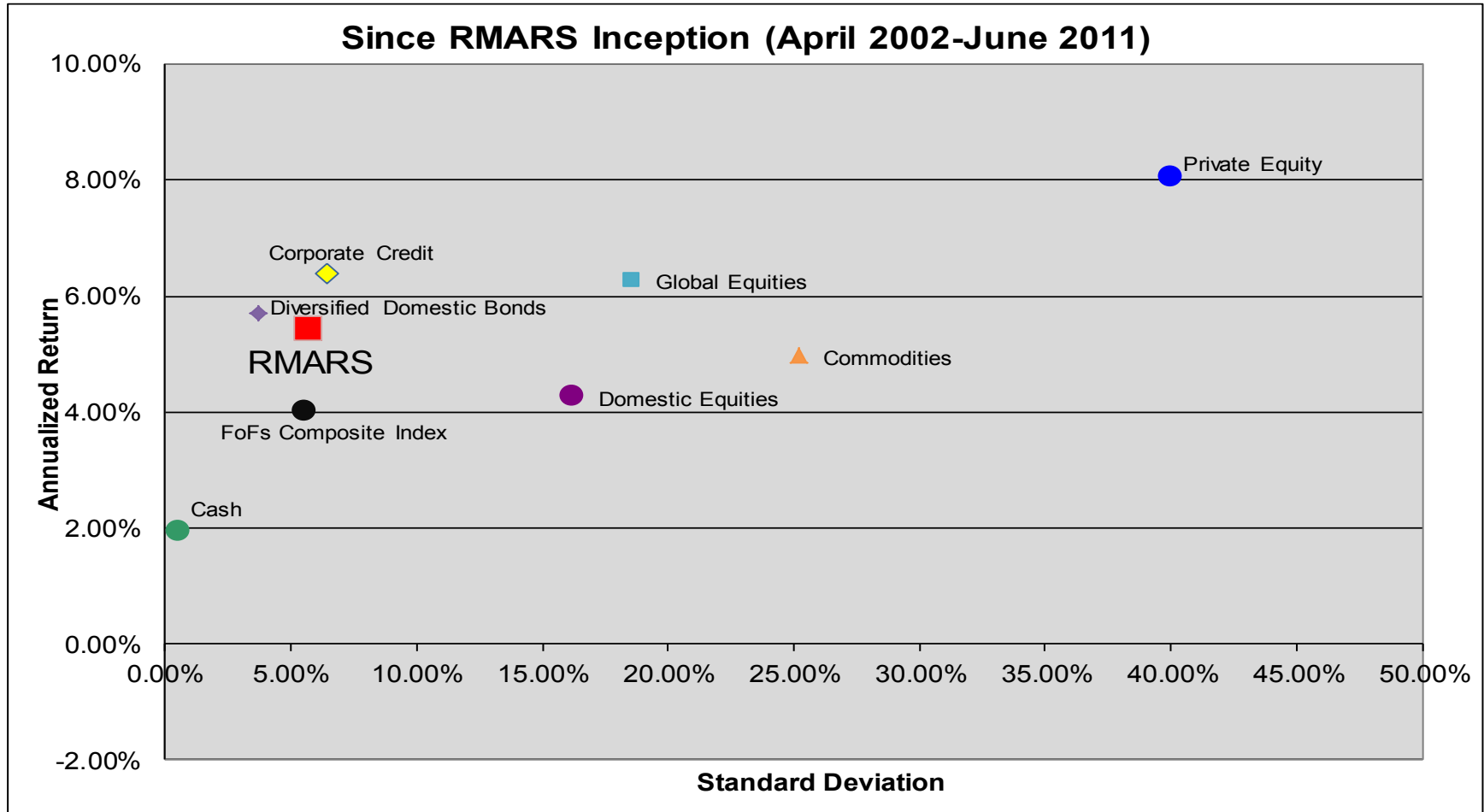
(*formerly known as RMARS)

- Role of Absolute Return Strategies Program
- Performance
- How Absolute Return Investing Benefits CalPERS
- Recent Accomplishments
- Spinoff from Global Equity
- Investment Process Evolution
- Next Steps
- Appendix: Absolute Return Strategies Program Overview

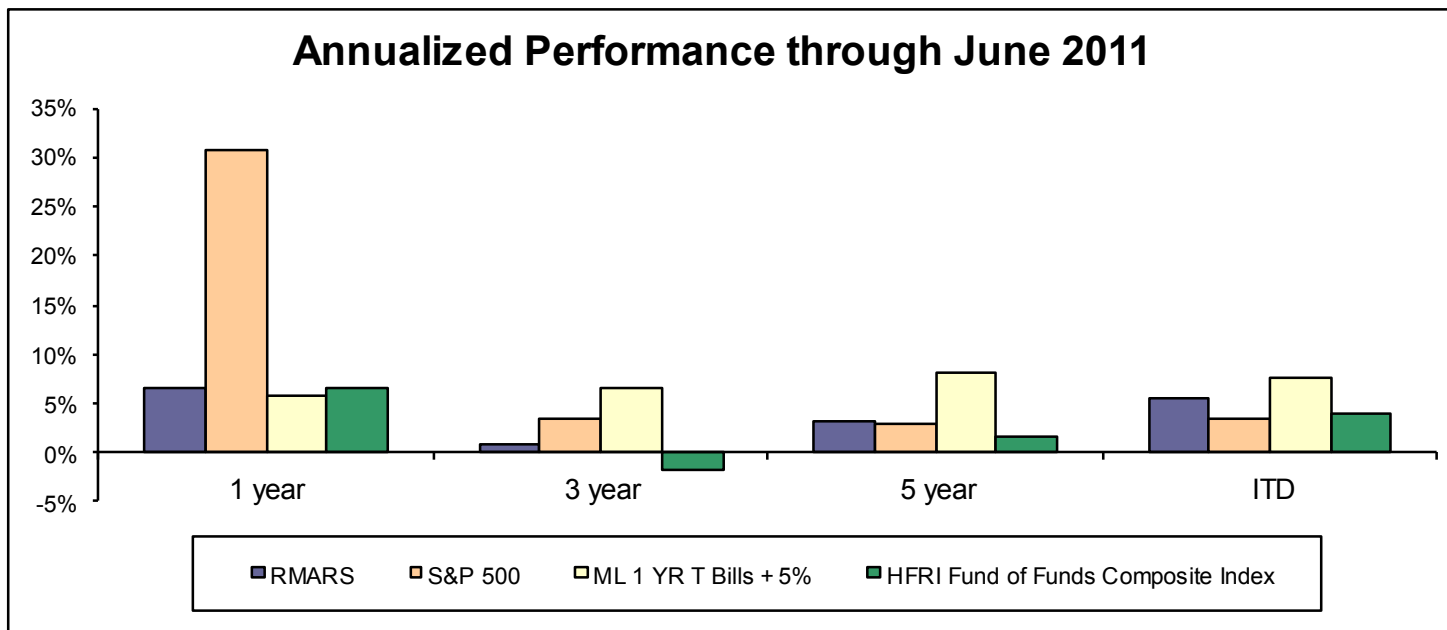
What is the Role of the Absolute Return Strategies Program?

- Provide absolute returns that exceed 1 year T-bills + 5% with less than half the volatility of public equities
- Improve the CalPERS total fund risk profile
- Focus on hedge fund strategies that:
 - Avoid directional investments that can be managed internally with minimal costs (“high-priced beta”)
 - Do not rely on the illiquidity risk premium as a primary source of return (AIM captures that risk premium)

ARS Return & Risk vs. Asset Class Benchmarks

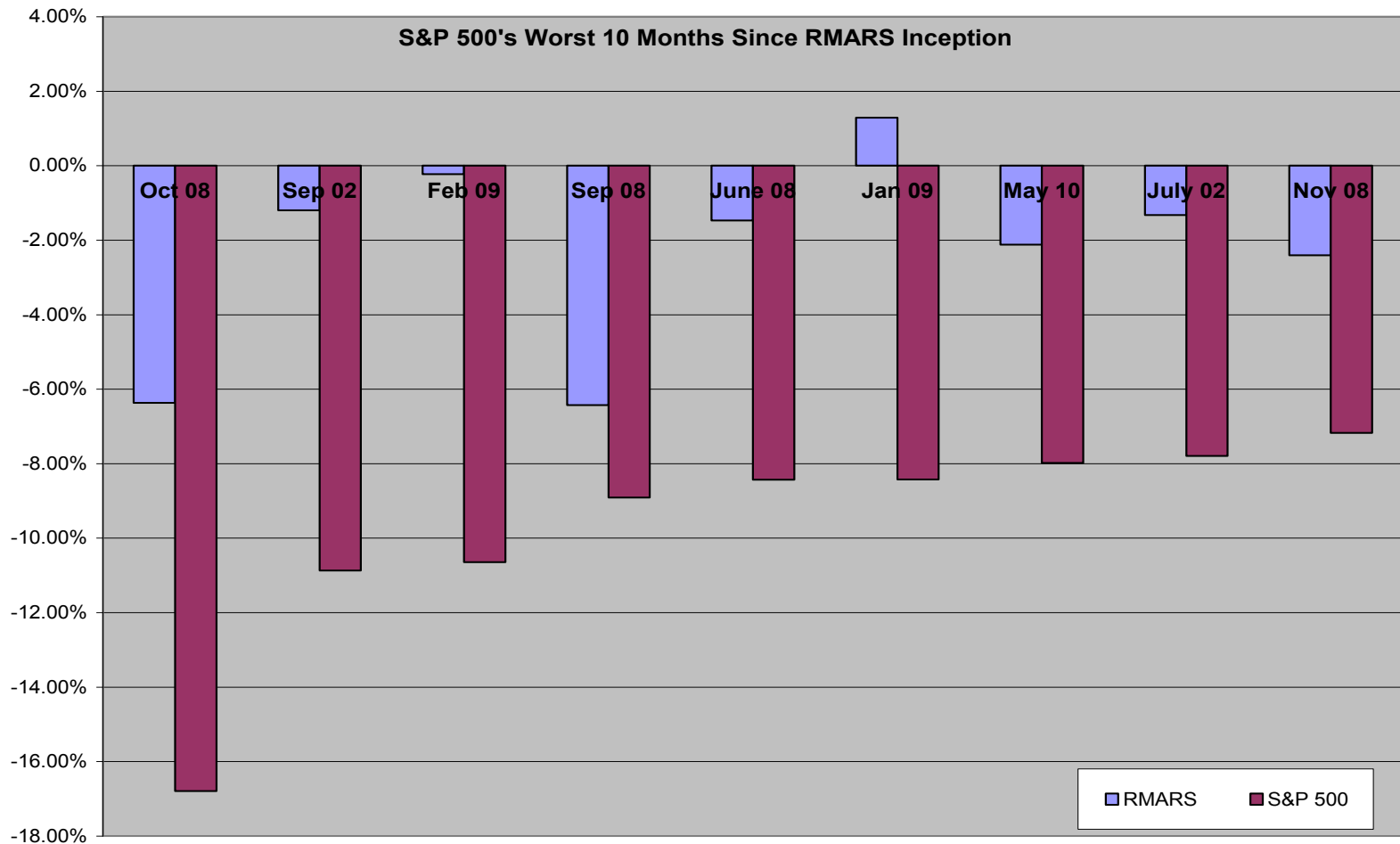


Absolute Return Strategies Program Performance

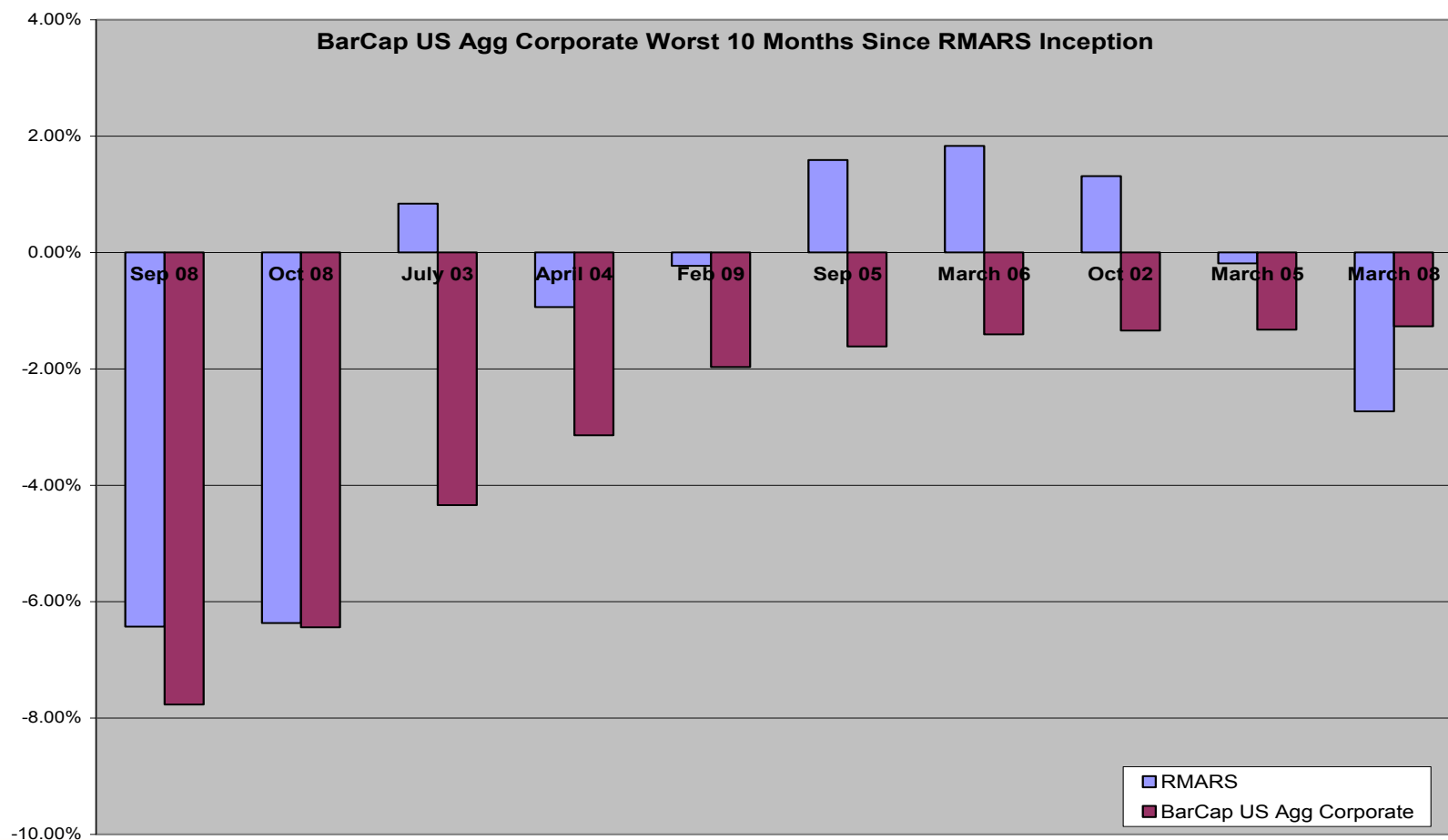


Annualized Standard Deviation through June 2011				
	RMARS	S&P 500	ML 1 YR T Bills + 5%	HFRI Fund of Funds Composite Index
1 year	3.71%	13.76%	0.13%	4.03%
3 year	6.82%	21.21%	0.61%	7.16%
5 year	6.42%	17.88%	0.96%	6.60%
ITD	5.66%	15.80%	3.97%	5.49%

The ARS Program During the Worst Months for Equities



The ARS Program During the Worst Months for Fixed Income



How Absolute Return Investing Benefits CalPERS

- Different risk premia from other allocations
 - Ability to short
 - Directional and/or relative value
 - Cross-asset class, cross-geography
- Strong risk/return profile historically
- Low correlation/beta with other asset classes
- Liquid markets used to obtain risk exposures
- Information flow to help CalPERS act dynamically

Absolute Return Program: Recent Accomplishments

- Execution on “Three Pillars” – Nine Separate Accounts:
 - Alignment:
 - Lower management fees
 - Encourages performance over asset-raising
 - Lower performance fees, payable over a longer timeframe
 - Encourages long-term performance
 - Control of assets:
 - Separate accounts to provide CalPERS with control
 - Transparency of risks and exposures:
 - Separate accounts also provide even better transparency and information flow than before
- Focus on liquid trading strategies with minimal overlap to existing strategies currently being managed in CalPERS

Absolute Return Strategies: Spinoff from Global Equity

- Spinning ARS from Global Equity allows:
 - Global Equity to be run as a “pure play” program focusing on generating strong equity returns
 - Absolute Return Strategies can be run as an “adaptive investing” program exploiting various risk premia (including equity risk premia as one among many) as/when conditions warrant

Absolute Return Strategies: Investment Process Evolution

- Investment process and partners evolve over time to reflect CalPERS overall needs
- ARS Advisory Committee will expand to include all asset classes (previously only Global Equity and AIM)
- ARS unit to report directly to CIO
- Investment process and partners unchanged:
 - Portfolio Advisor: UBS-AIS
 - Strategic Advisor: PAAMCO
 - Administrator: IFS/State Street
 - Fund of Hedge Funds: Eight customized FoHF's across Asia, Europe and emerging managers

Absolute Return Strategies: Next Steps

- Asset Allocation Framework
- Diversify Manager Roster
- Improve Information Flow “Up and Out” to other asset classes

Appendix: Absolute Return Strategies Program Overview

- What is the Absolute Return Strategies Program?
- What the ARS Program Expects from its Hedge Funds
- ARS Program History
- ARS Program Results

Appendix: What is the Absolute Return Strategies Program?

- A portfolio of managers seeking to generate returns by:
 - Dynamically allocating capital and risk to opportunities caused by anomalies within and across markets
 - Long/short equity & credit
 - Systematic trend following
 - Capital structure arbitrage
- Typically these are called “Hedge Funds”

Appendix: What the Absolute Return Program Expects from its Hedge Funds

- Returns lacking correlation to broad publicly-traded markets (low “beta”)
 - Ability to generate positive returns in a variety of market environments
 - Use absolute return rather than relative return targets (cash-plus instead of S&P-plus)
- Active and adaptive risk management
 - Modify risk exposures as conditions warrant (can be opportunistic or conservative)
 - Management of risks, not management of returns

Appendix: What the Absolute Return Program Expects from its Hedge Funds (cont'd)

- Leverage is used as a dynamic risk management tool
 - Compare hedge fund leverage (from 0 to 2.0x for most funds in Absolute Return Program) to the leverage used by most homeowners (from 5x to 20x)

Appendix: ARS Program History

- ARS launched April 1, 2002 as an equity adjunct; executed 2002-2004
 - Benchmark: combination of equity and absolute return (50% “1-year T-bills + 7%,” 50% Wilshire 2500)
- Plan at inception was to migrate to a multi-strategy format; executed 2005-2008
 - Benchmark: “1-year T-bills + 5%”
- Program in restructure/rebuild mode 2009-2011
 - “Three Pillars” market leadership – Alignment, Control, Transparency
 - Fifteen managers terminated, \$3B of capital received
- July 1, 2011: Spun out of Global Equity

Appendix: ARS Program Results – Market Sensitivities to the ARS Portfolio

	Correlation	RMARS β to:	Annualized Return	Annualized Standard Deviation	Sharpe Ratio (RFR=1.96%)	Drawdown
Diversified Domestic Bonds (BC US Agg Bond)	-0.03	-0.05	5.69%	3.73%	1.00	-3.83%
US Gov't Bonds (BC US Agg Treasury)	-0.32	-0.37	5.47%	4.97%	0.71	-4.97%
Corporate Credit (BC US Agg Corporate)	0.33	0.29	6.39%	6.43%	0.69	-15.42%
Domestic Equities (Russell 3000)	0.71	0.25	4.27%	16.20%	0.14	-51.20%
Global Equities (MSCI ACWI x US)	0.77	0.23	6.28%	18.57%	0.23	-58.16%
Private Equity (Wilshire Leveraged Buyout Index)	0.72	0.10	8.06%	40.00%	0.15	-83.49%
Global Real Estate (GPR G250 REIT Index)	0.62	0.17	11.72%	21.20%	0.46	-67.30%
Commodities (GSCI)	0.44	0.10	4.98%	25.21%	0.12	-67.65%
FoFs Composite Index (HFRI FOF Composite)	0.94	0.83	4.03%	5.49%	0.38	-22.08%
RMARS	1.00	1.00	5.46%	5.66%	0.62	-20.49%

Appendix: ARS Program Results – ARS Calendar Year Performance

	RMARS	RMARS Benchmark	S&P 500	MSCI World Index	HFRI Fund of Funds Composite
2002 Inception April 1	-1.26%	-7.47%	-22.31%	-20.16%	0.04%
2003	13.22%	19.33%	28.68%	33.11%	11.61%
2004	8.81%	6.95%	10.88%	14.72%	6.86%
2005	9.25%	7.41%	4.91%	9.49%	7.49%
2006	13.44%	9.53%	15.79%	20.07%	10.39%
2007	9.45%	11.21%	5.49%	9.04%	10.25%
2008	-19.60%	9.96%	-37.00%	-40.71%	-21.37%
2009	13.41%	5.83%	26.46%	29.99%	11.47%
2010	8.22%	5.87%	15.06%	11.76%	5.70%
2011 Through June 30	0.35%	2.83%	6.02%	5.29%	-0.33%

Appendix: ARS Program Results

Calendar Year Returns April 2002 - June 2011

